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8/31/76

APPROVED
JUL 31 1976

ACTION

THE WHITE HOUSE

Last Day: August 3

WASHINGTON
July 30, 1976

Posted
8/2/76

archives
8/2/76

MEMORANDUM FOR

THE PRESIDENT

FROM:

JIM CANNON

SUBJECT:

H.R. 11504-Negotiated Shipbuilding Contracting Act of 1976

Attached for your consideration is H.R. 11504, sponsored by Representatives Sullivan, Downing and Ruppe.

The enrolled bill would amend the Merchant Marine Act, 1936, to extend from June 30, 1976, to June 30, 1979, the authority of the Secretary of Commerce to award subsidies for the construction of vessels on which the price has been established by negotiation between the prospective ship purchaser and the shipyard. It would also increase the maximum subsidy level from 35% to 50%.

Additional information is provided in OMB's enrolled bill report at Tab A.

OMB, Max Friedersdorf, Counsel's Office (Lazarus) and I recommend approval of the enrolled bill.

RECOMMENDATION

That you sign H.R. 11504 at Tab B.



JUL 31 1976



EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

JUL 28 1976

MEMORANDUM FOR THE PRESIDENT

Subject: Enrolled Bill H.R. 11504 - Negotiated Shipbuilding Contracting Act of 1976
Sponsor - Rep. Sullivan (D) Missouri, Rep. Downing (D) Virginia and Rep. Ruppe (R) Michigan

Last Day for Action

August 3, 1976 - Tuesday

Purpose

To extend and amend the authority of the Commerce Department to provide subsidies for ship construction in U.S. shipyards.

Agency Recommendations

Office of Management and Budget

Approval

Department of Commerce

Approval

Discussion

H.R. 11504 would amend section 502(a) of the Merchant Marine Act, 1936, to extend from June 30, 1976, to June 30, 1979, the authority of the Secretary of Commerce to award subsidies for the construction of vessels on which the price has been established by negotiation between the prospective ship purchaser and the shipyard. It would also increase the maximum subsidy level from 35% to 50%.

The Merchant Marine Act of 1936 authorizes the Maritime Administration (MARAD) to issue ship construction subsidies. To be eligible for a subsidy a ship must be: (a) built in a U.S. yard; (b) owned by a U.S. citizen; (c) operated under the U.S. flag; (d) manned by a U.S. crew; and (e) employed in U.S. foreign commerce. MARAD computes the subsidy by comparing the actual price of a U.S. built

vessel with the apparent cost of building the same vessel abroad. The intent is to remove the cost disparity which exists between U.S. and foreign shipyards and thus encourage more domestic shipbuilding.

Prior to 1970, all the subsidy contracts were let on a competitive bid basis, with the subsidy rates averaging 50-55%, i.e., the Government paid for more than half the cost of subsidized vessels. For a variety of reasons, the Executive branch and the Congress felt that competitive award procedures were inadequate. As a consequence, the 1970 Amendments to the Merchant Marine Act authorized shipyards and ship purchasers, as an alternative to competitive bidding, to negotiate ship prices so long as the resulting subsidy rates were within ceiling rates established in the legislation. These ceiling rates declined 2% annually -- from 45% in 1971 to the current 35% in 1976 (but no further). MARAD also was authorized to permit competitive bid contracts up to a maximum 50% subsidy rate. The advantage foreseen in negotiated contracting was the encouragement of shipyards to design standardized vessels which they could market to shipowners, thereby resulting in longer production runs and lower unit production costs. Under competitive bidding, shipyards were reluctant to go to the expense of designing a ship since they might not be the low bidder on the contract. Between 1970 and 1975, all contracting for ship construction was by negotiated contracts and all awards were within the ceiling rates.

In recent months, however, it has become clear that without an increase in the subsidy rates, it is unlikely that many new U.S. flag ships will be built for U.S. foreign trade. Because of a worldwide decline in ship orders, foreign shipyards (particularly the Japanese) are cutting prices to attract more business. U.S. shipyards generally do not have the financial strength to reduce their prices proportionately. In addition, because of the recent increasing strength of the dollar, relative prices of foreign vessels have been going down.

The Department of Commerce transmitted a legislative proposal to the Congress which provided that the negotiated rate be raised only to 45%, and that contracts under 35% be given first priority. While the 50% subsidy level provided by the enrolled bill is undesirable, it does not raise serious enough issues to warrant disapproval of the legislation. It is expected that



actual contracts will contain subsidy rates in the range of 20-25% for liquefied natural gas carriers, 40-45% for container-ships, and 45-50% for bulk carriers (including tankers). In its attached views letter on the enrolled bill Commerce states that the negotiated pricing approach that would be provided by H.R. 11504 "still would allow us to achieve important savings in subsidy payments ..."

James M. Frey
Assistant Director for
Legislative Reference

Enclosures



**GENERAL COUNSEL OF THE
UNITED STATES DEPARTMENT OF COMMERCE**
Washington, D.C. 20230

JUL 26 1976

Honorable James T. Lynn
Director
Office of Management and Budget
Washington, D. C. 20503

Attention: Assistant Director for Legislative Reference

Dear Mr. Lynn:

This is in reply to your request for the views of this Department concerning H. R. 11504, an enrolled enactment

"To amend section 502(a) of the Merchant Marine Act, 1936."

The purpose of the enrolled enactment is to extend, from June 30, 1976 to June 30, 1979, the authority of the Secretary of Commerce to award subsidies for the construction of vessels with respect to which the price has been established by negotiation between the prospective ship purchaser and the shipyard. The bill also (1) provides that the same ceiling on the subsidy rate shall apply to negotiated shipbuilding contracts as to contracts awarded as a result of competitive bidding, (50% of the cost excluding the cost of national defense features) and (2) eliminates various references to the Commission on American Shipbuilding and to annual guideline rates which are no longer operative.

Section 502(a) originally provided that negotiated contracts for ship construction with subsidy could provide for subsidy payments on a sliding scale ranging from 45% of cost for contracts entered into in fiscal 1971 to 35% of cost in fiscal 1976. As noted above, the authority for negotiated pricing under this subsection expired on June 30 of this year.

The Department believes that even though the enrolled enactment provides the same ceiling on subsidy payments under negotiated contracts as may be paid for contracts entered into by competitive bidding, the negotiated pricing approach still would allow us to achieve important savings in subsidy payments through the use of such devices as negotiated contracts for serial or standard ship construction. Moreover, current world-wide ship construction conditions make it unlikely

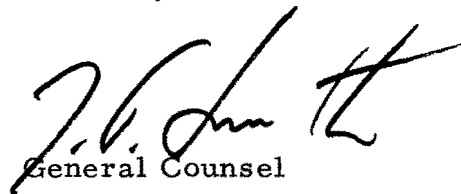


that a balanced ship construction program could be undertaken under negotiated pricing contracts if limits such as the 35% applicable to contracts negotiated in 1976 were to be continued. Of course the Department, in negotiating prices would strive to go as far below a 50% subsidy rate as possible.

Accordingly, the Department recommends approval by the President of H.R. 11504.

Enactment of this legislation is expected to involve no increase in budgetary requirements for the Department.

Sincerely,



General Counsel

THE WHITE HOUSE

ACTION MEMORANDUM

WASHINGTON

LOG NO.:

Date: July 29

Time: 930am

FOR ACTION: Paul Leach
Max Friedersdorf *mc* (for information): Jack Marsh
Ken Lazarus *m* Jim Cavanaugh
Ed Schmults

FROM THE STAFF SECRETARY

DUE: Date: July 30

Time: noon

SUBJECT:

H.R. 11504-Negotiated Shipbuilding Contracting Act
of 1976

ACTION REQUESTED:

- For Necessary Action
- For Your Recommendations
- Prepare Agenda and Brief
- Draft Reply
- For Your Comments
- Draft Remarks

REMARKS:

please return to judy johnston, ground floor west wing



PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

K. R. COLE, JR.
For the President

THE WHITE HOUSE

MEMORANDUM

WASHINGTON

LOG NO.:

Date: July 29

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FOR ACTION: Paul Leach
Max Friedersdorf
Ken Lazarus

cc (for information): Jack Marsh
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For Necessary Action

For Your Recommendations

Prepare Agenda and Brief

Draft Reply

For Your Comments

Draft Remarks

REMARKS:

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No objection -- Ken Lazarus 7/29/76

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James M. Cannon
For the President

THE WHITE HOUSE

MEMORANDUM

WASHINGTON

LOG NO.:

July 29

Time: 930am

FOR ACTION: Paul Leach
Max Friedersdorf
Ken Lazarus

MAJ

cc (for information): Jack Marsh
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If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately.

James H. Cannon
For the President

To-
J. Conaway
7-28-76
6:00 p.m.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

JUL 28 1976

MEMORANDUM FOR THE PRESIDENT

Subject: Enrolled Bill H.R. 11504 - Negotiated Shipbuilding Contracting Act of 1976
Sponsor - Rep. Sullivan (D) Missouri, Rep. Downing (D) Virginia and Rep. Ruppe (R) Michigan

Last Day for Action

August 3, 1976 - Tuesday

Purpose

To extend and amend the authority of the Commerce Department to provide subsidies for ship construction in U.S. shipyards.

Agency Recommendations

Office of Management and Budget	Approval
Department of Commerce	Approval

Discussion

H.R. 11504 would amend section 502(a) of the Merchant Marine Act, 1936, to extend from June 30, 1976, to June 30, 1979, the authority of the Secretary of Commerce to award subsidies for the construction of vessels on which the price has been established by negotiation between the prospective ship purchaser and the shipyard. It would also increase the maximum subsidy level from 35% to 50%.

The Merchant Marine Act of 1936 authorizes the Maritime Administration (MARAD) to issue ship construction subsidies. To be eligible for a subsidy a ship must be: (a) built in a U.S. yard; (b) owned by a U.S. citizen; (c) operated under the U.S. flag; (d) manned by a U.S. crew; and (e) employed in U.S. foreign commerce. MARAD computes the subsidy by comparing the actual price of a U.S. built

NEGOTIATED CONTRACTING

MARCH 2, 1976.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mrs. SULLIVAN, from the Committee on Merchant Marine and Fisheries, submitted the following

REPORT

[To accompany H.R. 11504]

The Committee on Merchant Marine and Fisheries, to whom was referred the bill (H.R. 11504) to amend section 502(a) of the Merchant Marine Act, 1936, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert the following:

That the third sentence of section 502(a) of the Merchant Marine Act, 1936 (46 U.S.C. 1152(a)) is amended as follows:

(1) By striking out "June 30, 1976," and inserting in lieu thereof "June 30, 1979,".

(2) By striking out of subdivision (1) the words "in fiscal 1971, 43 per centum in fiscal 1972, 41 per centum in fiscal 1973, 39 per centum in fiscal 1974, 37 per centum in fiscal 1975, and 35 per centum in fiscal 1976".

PURPOSE OF THE BILL

The purpose of the bill, H.R. 11504, is to amend section 502(a) of the Merchant Marine Act, 1936, to extend from June 30, 1976, to June 30, 1979, the authority of the Secretary of Commerce to award subsidy for the construction of vessels on which the price has been established by negotiation between the prospective ship owner and the shipyard. The present authority of the Secretary under section 502(a) is scheduled to expire on June 30, 1976. The bill would also delete the so-called Guideline Rates set forth in the subsection, so that a contract arrived at by negotiated bidding could qualify for a Construction-differential Subsidy rate of up to 45 percent.

BACKGROUND OF THE LEGISLATION

Section 505 of the Merchant Marine Act, 1936, provides that all construction for which a Construction-differential Subsidy is allowed

shall be performed as a result of competitive bidding. However, the Merchant Marine Act of 1970 (Public Law 91-469), amended section 502(a) of the 1936 Act, to provide that notwithstanding the provisions of section 505 of the 1936 Act, the Secretary of Commerce would be authorized at any time prior to June 30, 1973, to accept a price for the construction of a ship that has been negotiated between a shipbuilder and a proposed ship purchaser if: (1) The price yields a subsidy rate that is equal to or less than the so-called Guideline Rates of 45 percent in fiscal 1971, 43 percent in fiscal 1972, and 41 percent in fiscal 1973; (2) the proposed ship purchaser and the shipyard submit backup cost details and evidence that the price is fair and reasonable; (3) the Secretary of Commerce finds that the negotiated price is fair and reasonable; and (4) the shipyard agrees that the Comptroller General of the United States shall, until three years after final payment, have the right to examine any pertinent books, documents or records of the shipyard or its subcontractors related to the negotiation or performance of the contract.

Negotiated Procurement proved so successful that in 1973 it was extended for an additional three years by Public Law 93-71. In this regard, the specified Guideline Rates are 39 percent in fiscal year 1974, 37 percent in fiscal 1975, and 35 percent in fiscal 1976, and thereafter. This authority is scheduled to expire on June 30, 1976.

The system of direct negotiation in lieu of competitive bidding is consistent with the general practice of shipyards throughout the world. At the time of the passage of the 1970 Act, it was believed that negotiated procurement would promote greater efficiency and cost savings by our shipyards. It was, in short, a challenge to the American Shipbuilding Industry. In addition, the prospective ship purchaser would be afforded an opportunity to select and work with the shipyard he believed would best meet his individual needs.

HEARINGS

At the present time, your Committee is conducting the most comprehensive Oversight Hearings with respect to the United States-flag merchant marine since the enactment of the Merchant Marine Act of 1970. During the course of these hearings, it became increasingly clear that negotiated contracting subject to the Guideline Rates had been successful. All 58 vessels constructed with Construction-differential Subsidy pursuant to the building program provided by the Merchant Marine Act of 1970, resulted from the negotiated contracting authority provided by section 502(a). However, it has also become clear that, due to a number of factors not envisioned when the Merchant Marine Act of 1970 was enacted, and over which U.S.-flag operators and American shipyards have no control, it is no longer possible to construct certain type vessels, such as Containerships, with subsidy at the suggested Guideline Rate of 35 percent. Therefore negotiated contracting can not be used, and the more inefficient competitive bidding process must be utilized.

The so-called Oil Crisis, and accompanying world recession had a disastrous effect on all American industries, including the shipbuilding industry. Additionally, the reduced demand for petroleum products which followed the Oil Crisis caused the world tanker market to

collapse and resulted in the widespread cancellation of tanker construction contracts. This has severely depressed foreign prices and forced the Japanese to construct vessels at prices than can only be construed as "dumping". As Construction-differential Subsidy is measured against foreign prices, this has had a detrimental effect on the percentage amount of subsidy required to construct vessels in American shipyards. The problem has been further compounded by inflation and the strengthening of the dollar in relation to foreign currencies. At these Oversight Hearings, the American Institute of Merchant Shipping, representing the vast majority of United States-flag Liner operators, and the Shipbuilders' Council of America, representing the American Shipbuilding Industry, and Sea-Land Service, Inc., the United States' largest steamship operator, recommended the removal of the Guideline Rates in view of these unforeseen events, so that United States-flag operators could continue to use the more efficient negotiated contracting procedure. The Assistant Secretary of Commerce for Maritime Affairs expressed grave concern with respect to this situation, and was of the opinion that competitive bidding is a very wasteful, senseless way to go about constructing ships. However, Mr. Blackwell could not give your Committee the position of the Administration in this regard.

Thereafter, it came to the attention of your Committee that proposed legislation, similar to H.R. 11504, is currently being held in the Executive Branch. Due to the critical nature of the problem, your Committee introduced its own bill, and considered the legislation during the first hearing held by the Subcommittee on Merchant Marine in the Second Session of the 94th Congress. On January 27, 1976, hearings were held on H.R. 11481, the authorization request of the Maritime Administration for fiscal year 1977, and H.R. 11504, the subject bill.

The Assistant Secretary of Commerce for Maritime Affairs, Robert J. Blackwell, testified that funds for Construction-differential Subsidy were not required for fiscal year 1977, because the projected program of \$247 million could be funded from monies not used in previous years. This carryover is the result of the above-mentioned adverse World conditions which have led to a sharp decline in new vessel orders.

Mr. Blackwell further indicated that since the enactment of the Merchant Marine Act of 1970, all subsidized, and probably all non-subsidized shipbuilding contracts, have been entered into through the negotiated contracting procedure. With respect to subsidized construction, the subsidy levels for these contracts have all been within the Guideline Rates, which declined two percent annually from 45 percent in fiscal year 1971, to the current rate of 35 percent. It was his opinion that Containerships, Product Carriers, and Bulk Vessels would be difficult, if not impossible, to construct at the current Guideline Rate of 35 percent. Since Construction-differential Subsidy up to 50 percent is permissible when the competitive bidding procedure is employed, this more inefficient method of contracting for vessels will have to be used if the law is not changed. The Assistant Secretary was of the view that the statute should be liberalized to permit negotiated contracting. The Maritime Administration has submitted such

legislation to the Administration and is awaiting a decision. It is now up to the Administration and the Congress to make a decision as to the type of authority that the Maritime Administration should have in this regard.

In addition to the testimony of the Assistant Secretary of Commerce for Maritime Affairs, your Committee received statements in strong support of H.R. 11504 from the Shipbuilders' Council of America, the American Institute of Merchant Shipping, the Transportation Institute and Sea-Land Service, Inc.

COMMITTEE AMENDMENT

As originally introduced, the bill permitted construction subsidy of up to 50 percent for contracts arrived at by negotiated bidding. It would, therefore, have made the negotiated bidding and competitive bidding rate ceilings identical.

However, your Committee felt that it was important to insure that subsidy rates be kept as low as possible and concluded that the need for a subsidy in excess of 45 percent had not been conclusively demonstrated. During Oversight Hearings in October, 1975, the Maritime Administration testified that the effective differential between foreign and domestic costs was 43 percent; although the Committee was informed by letter from the American Institute of Merchant Shipping that the differential in some cases has risen since then to a current rate of 48 percent, the Committee concluded that the lower 45 percent guideline should be adopted until more detailed information to justify a higher rate was presented in testimony before the Committee. A rate up to 50 percent may continue to be awarded if construction contracts are awarded by competitive bidding.

Accordingly, the bill was amended to provide that the construction subsidy rate must be 45 percent or below before negotiated contracting may be used.

CONCLUSION

As world conditions change, corresponding adjustments must be made to the statute if the Merchant Marine Act of 1936 is to remain an effective aid to the maritime requirements of the United States. Your Committee concludes that H.R. 11504 would amend section 502(a) of that Act so that the intent of the Congress with respect to the construction of United States-flag vessels can be carried out in the most efficient manner. Your Committee further concludes that existing market conditions and the statutory standards of section 502(a) insure that the public interest is adequately protected. In addition, the extension of negotiated contracting provided by the bill is for three years only, and will be thoroughly examined during the annual Oversight Hearings held by your Committee.

H.R. 11504, as amended, was reported unanimously.

COST OF THE LEGISLATION

Enactment of the bill will not result in any additional cost to the Federal Government.

COMPLIANCE WITH CLAUSE 2(1)(3) OF RULE XI

With respect to the requirements of Clause 2(1)(3) of House Rule XI of the Rules of the House of Representatives—

(A) Extensive oversight hearings on the entire maritime capability of the United States, including Section 502(A) of the Merchant Marine Act, 1936, were commenced during the last session of Congress and are continuing during the present session.

(B) Section 308(a) of the Congressional Budget Act of 1974 is not applicable.

(C) No estimate and comparison of costs has been received by the Committee from the Director of the Congressional Budget Office, pursuant to section 403 of the Congressional Budget Act of 1974.

(D) The Committee on Government Operations has sent no report to the Committee on Merchant Marine and Fisheries pursuant to Clause 2(b)(2) of Rule X.

INFLATIONARY IMPACT STATEMENT

Pursuant to Clause 2(1)(4) of Rule XI of the Rules of the House of Representatives, the Committee estimates that the enactment of H.R. 11504 would have no significant inflationary impact on the prices and costs in the national economy.

CHANGES IN EXISTING LAW

In compliance with clause 3 of rule XIII of the Rules of the House of Representatives, as amended, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman) :

SECTION 502(a) OF THE MERCHANT MARINE ACT, 1936, AS AMENDED (46 U.S.C. 1152(a))

SEC. 502. (a) If the Secretary of the Navy certifies his approval under section 501(b) of this Act, and the Secretary of Commerce approves the application, he may secure bids for the construction of the proposed vessel according to the approved plans and specifications. If the bid of the shipbuilder who is the lowest responsible bidder is determined by the Secretary of Commerce to be fair and reasonable, the Secretary of Commerce may approve such bid, and if such approved bid is accepted by the proposed ship purchaser, the Secretary of Commerce is authorized to enter into a contract with the successful bidder for the construction, outfitting, and equipment of the proposed vessel, and for the payment by the Secretary of Commerce to the shipbuilder, on terms to be agreed upon in the contract, of the contract price of the vessel, out of the construction fund hereinbefore referred to, or out of other available funds. Notwithstanding the provisions of the first sentence of section 505 of this Act with respect to competitive bidding, the

Secretary of Commerce is authorized, at any time prior to [June 30, 1967,] *June 30, 1979*, to accept a price for the construction of the ship which has been negotiated between a shipyard and a proposed ship purchaser if (i) the negotiated price will result in a construction-differential subsidy that is equal to or less than 45 per centum [in fiscal 1971, 43 per centum in fiscal 1972, 41 per centum in fiscal 1973, 39 per centum in fiscal 1974, 37 per centum in fiscal 1975, and 35 per centum in fiscal 1976]; (ii) the proposed ship purchaser and the shipyard submit backup cost details and evidence that the negotiated price is fair and reasonable; (iii) the Secretary of Commerce finds that the negotiated price is fair and reasonable; and (iv) the shipyard agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment have access to and the right to examine any pertinent books, documents, papers, and records of the shipyard or any of its subcontractors related to the negotiation or performance of any contract or subcontract negotiated under this subsection and will include in its subcontracts a provision to that effect. Concurrently with entering into such contract with the shipbuilder, the Secretary of Commerce is authorized to enter into a contract for the sale of such vessel upon its completion, to the applicant if he is the proposed ship purchaser and if not to another citizen of the United States, if the Secretary of Commerce determines that such citizen possess the ability, experience, financial resources, and other qualifications necessary for the operation and maintenance of the vessel at a price corresponding to the estimated cost, as determined by the Secretary of Commerce pursuant to the provisions of this Act, of building such vessel in a foreign shipyard.

○

NEGOTIATED SHIPBUILDING CONTRACTING ACT OF 1976

JUNE 29 (legislative day, JUNE 18), 1976.—Ordered to be printed

Mr. INOUE (for Mr. LONG), from the Committee on Commerce,
submitted the following

REPORT

[To accompany S. 3171]

The Committee on Commerce, to which was referred the bill (S. 3171), to amend section 502(a) of the Merchant Marine Act, 1936, having considered the same, reports favorably thereon with an amendment in the nature of a substitute and an amendment to the title and recommends that the bill as amended do pass.

PURPOSE AND DESCRIPTION

The purpose of the bill is to extend, from June 30, 1976 to June 30, 1979, the authority of the Secretary of Commerce to award subsidies for the construction of vessels with respect to which the price has been established by negotiation between the prospective ship purchaser and the shipyard. The bill also (1) provides that the same ceiling on the subsidy rate shall apply to negotiated shipbuilding contracts as to contracts awarded as a result of competitive bidding, and (2) eliminates various references to the Commission on American Shipbuilding and to annual guideline rates which are no longer operative.

BACKGROUND

Section 502(a) of the Merchant Marine Act, 1936, provides that the Secretary of Commerce may, at any time prior to June 30, 1976, accept a price negotiated between a proposed ship purchaser and a shipyard for the construction of a vessel, for the purpose of computing construction-differential subsidy, (CDS) if—

- (1) The price will result in a construction-differential subsidy that is equal to or less than 45 percent in the fiscal year ending in 1971, 43 percent in the fiscal year ending in 1972, 41 percent in

the year ending in 1973, 39 percent in the fiscal year ending in 1974, 37 cent in the fiscal year ending in 1975, and 35 percent in the fiscal year ending in 1976;

(2) The proposed ship purchaser and the shipyard submit backup cost details and evidence that the negotiated price is fair and reasonable;

(3) The Secretary of Commerce finds that the negotiated price is fair and reasonable; and

(4) The shipyard agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of 3 years after final payment, have access to and the right to examine any pertinent books, documents, papers, and records of the shipyard or any of its subcontractors related to the negotiation or performance of any contract or subcontract negotiated under this subsection and will include in its subcontracts a provision to this effect.

As an alternative to negotiation between the proposed ship purchaser and the shipyard, section 502(b) provides for placing of ship construction contracts on which construction-differential subsidy will be paid by competitive bidding. Under this procedure, the Secretary of Commerce may pay construction-differential subsidy in an amount up to 50 percent of the United States construction cost of the vessel.

Section 502(b) further provides that, commencing with the fiscal year ending in 1972, no construction contract requiring a construction-differential subsidy in excess of the guideline percentages set forth in section 502(a) shall be entered into unless the Secretary shall have given due consideration to the likelihood that the commitment to the ship construction program may not be continued. The section provides that if the Secretary enters into a contract requiring a construction-differential subsidy in excess of these guidelines (35 percent for fiscal year 1976), he shall notify the Commission on American Shipbuilding. Not later than 6 months after such notification, the Commission shall submit its report on the American shipbuilding industry. However, this Commission ceased to exist on December 20, 1973.

The authority contained in section 502(a) to award subsidy based upon negotiated contracts between the ship purchaser and shipyard was enacted by the Merchant Marine Act of 1970 (Public Law 91-469) for a period of 3 years ending June 30, 1973. Following review, this authority was extended for an additional 3 year period, until June 30, 1976, by Public Law 93-71.

Prior to enactment of the Merchant Marine Act of 1970, ship construction subsidy under title V of the Merchant Marine Act, 1936 could only be awarded on the basis of competitively bid contracts.

The contractual process under competitive bidding is expensive, time consuming, and inflexible. It requires that the United States government contract with the shipyard to build the ship and with the ship operator to buy the vessel from the United States upon completion. Any dispute over cost, material deficiency, or performance failure automatically involves the United States as a contract purchaser. Litigation between the United States and shipyards under this procedure has been frequent and protracted. Under the negotiated bidding process adopted in 1970, the shipyard and operator contract directly for the construction of the ship. The United States agrees to pay the ship-

yard the construction subsidy, subject to the various statutory safeguards set forth in section 502(a). The Merchant Marine Act, 1936, was amended in 1970 to permit negotiated pricing to encourage shipyards to design vessels to be marketed to prospective ship purchasers. This process could result in a longer production run for the same type of vessel, which could lower the unit cost of each vessel.

The 1970 Act has been successful in inducing shipyards to design vessels. For example, National Steel and Shipbuilding Company designed a 90,000 deadweightton (dwt) tanker and a 38,000 dwt tanker. Bethlehem Steel corporation designed a 265,000 dwt tanker. Seatrain Shipbuilding Corporation designed a 225,000 dwt tanker. Newport News Shipbuilding & Drydock Company designed a 390,000 dwt tanker. Avondale Shipyards, Inc. designed a modification of a LASH vessel. All three designs of Liquefied Natural Gas (LNG) carriers were developed by shipyards. Shipyards could not reasonably be expected to design vessels if competitive bidding were the method of procuring vessels, because the shipyard that designed the vessel at its own expense might not be the low bidder.

A further goal of the 1970 Act was the gradual reduction of subsidy rates according to a sliding scale, from 45 percent in fiscal year 1971 to 35 percent in fiscal year 1976. These guideline subsidy rates were tied to the work of the Commission on American Shipbuilding, which were also established by the 1970 Act. If a contract failed to meet the guideline rate for the year, the Secretary of Commerce was required to report this fact to the Commission thereby triggering prematurely the submission of a report on the status of the shipbuilding industry by the Commission.

All contracts entered into under authority of the 1970 Act have met the guideline rates. The final report of the Commission was rendered in 1973 as required by law.

LEGISLATIVE HISTORY

S. 3171 was introduced by Senator Beall on March 18, 1976 and was referred to the Committee on Commerce. The Subcommittee on Merchant Marine held a hearing on the bill on April 8, 1976. On June 2, 1976, the Committee, in open executive session, ordered the bill to be reported favorably with an amendment.

NEED

The present authority to negotiate contracts for the construction of ships to be built with construction-differential subsidy assistance expires June 30, 1976. The bill extends this authority for a period of 3 years ending June 30, 1979.

The guideline rates set forth in the Merchant Marine Act of 1970 now call for a maximum subsidy rate of 35 percent, in the case of negotiated contracts. Contracts resulting from competitive bidding may, however, receive a maximum construction-differential subsidy of 50 percent. This difference in the maximum subsidy rate stems from the manner in which the 1970 Act was drafted, as a series of technical amendments to existing sections of the Merchant Marine Act, 1936.

No justification for this distinction was advanced during the consideration of the 1970 Act. Both methods of contracting are intended

to enable a ship purchaser to acquire a vessel built in the U.S. at a cost no higher than it would pay to have the ship built in a representative foreign shipyard. The subsidy payable represents the difference between the domestic and foreign cost of construction; it is a subsidy to the shipyard, not to the vessel operator. The subsidy permits U.S. flag operators to acquire ships from U.S. yards at prices comparable to those paid by their foreign shipping competitors from foreign yards. Raising the subsidy rate ceiling for negotiated contracts will not increase the CDS authorization. The fact that the ceiling is set at 50 percent does not mean that all or any awards will be made at that level.

The rate of subsidy required for vessels varies dramatically for various ship types and reflects both technological and competitive influences. For example, the subsidy rate for LNG vessels was most recently set at 16.9 percent, although it is expected to rise to 20-25 percent as foreign shipyards overcome U.S. technological leads. The rates on more conventional types of ships, bulk carriers and container-ships, due to strong competitive pressures abroad, have increased from below the current 35 percent guideline to nearly 50 percent in the case of the most recent contract awarded under competitive bidding. The Secretary of Commerce can pay this higher rate only in the case of competitive bidding. Since, throughout fiscal year 1976, the current level of subsidy required to equalize U.S. and foreign shipbuilding costs for most vessels has exceeded 35 percent, the authority to negotiate contracts was effectively terminated prior to the statutory termination date of June 30, 1976.

This differential resulted in the rejection of negotiated contracts for the construction of three containerships for a U.S. flag operator last year. The operator was compelled to resort to competitive bids under the 1936 Act system and, after a year's delay, a new contract was signed on June 11, 1976, with a subsidy rate of 49.64 percent. Due to cost escalation in the interim, the low competitive bid price is substantially higher than the earlier negotiated price.

There are a number of reasons why an increased construction-differential subsidy rate is required. The rate represents the excess of the actual United States contract price over the price of constructing a similar vessel in a foreign yard, expressed as a percentage of the United States contract price. The objective of the construction-differential subsidy is to enable U.S. ship operators to acquire their vessels at their foreign cost, as their competitors do. Several factors affect the differential between American and foreign contract prices for ships. The exchange rate, the relative size of the order books in American and foreign shipyards, the relative financial strength of American and foreign shipyards, the relative inflation rates in the United States and foreign countries, the relative productivity of American and foreign shipyards, and foreign government assistance to their shipyards.

During the period from late 1971 to early 1975, the dollar weakened in relation to the currencies of the major shipbuilding countries. This facilitated the decrease in construction-differential subsidy rates that was achieved during this period. However, beginning in 1975, the dollar has gained strength, with concomitant upward pressure on the differential rate. Also, the world shipbuilding industry is in a state

of depression, and the prospects for early recovery are not encouraging. There are two major reasons for this depression: (1) the major reversal in the requirements for tankers, and (2) the results of speculative shipbuilding in recent years.

This has led to an excess of supply of vessels coupled with greatly reduced demand. This situation appears likely to persist, and with tanker demand near zero, world order books have declined significantly. There is evidence that some foreign builders are resorting to desperation price cutting to attract the few available shipbuilding orders to keep their labor force employed, regardless of true costs. The lowering of foreign ship building prices imposes upward pressure on construction-differential subsidy rates.

In summary, foreign shipyards are being forced to reduce their prices, and their financial strength makes it possible for them to do so. Further, the strengthening of the dollar is decreasing the effective costs of foreign-built ships to U.S. buyers. Finally, the U.S. shipyards do not have the financial strength to reduce their prices appreciably.

These factors substantially negate any possibility of subsidy rates on other than high technology vessels being reduced to the range contemplated by the 1970 Act.

The practical effect has been to preclude negotiated contracting and to force ship purchasers to return to the wasteful and time consuming process of competitive bidding. No valid public purpose is served by a return to competitive bidding in the award of shipbuilding contracts. It is contrary to industry practice both in the United States and throughout the world. In order to continue to achieve the economies inherent in shipyard-purchaser negotiation in the design and construction of ships, the artificial ceiling on negotiated contracting must be lifted.

All of the safeguards built into the 1970 Act to insure that negotiated prices are fair and reasonable are continued, including GAO audit of the shipbuilder and all subcontractors.

The Assistant Secretary of Commerce for Maritime Affairs, Robert J. Blackwell, testified at the Committee's hearings on S. 3171 that all ships built with subsidy assistance since 1970 have been the result of negotiated contracting. He characterized competitive bidding as "costly and time consuming." Perhaps more importantly, however, he stressed that negotiated contracting facilitates the development of standardized vessels for series production runs, which, because of the learning curve, produce economies that can be passed on not only to the purchaser, but to the taxpayer as well.

ESTIMATED COST

In accordance with section 252(a) of the Legislative Reorganization Act of 1970 (Public Law 91-510), the Committee estimates that there would be no additional cost incurred by this Act. The Committee is not aware of any estimates of cost made by any Federal agency which are different from those made by the Committee.

CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill as re-

ported are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

The Merchant Marine Act, 1936

* * * * *

“SEC. 502. (a) If the Secretary of the Navy certifies his approval under section 501(b) of this Act, and the Secretary of Commerce approves the application, he may secure bids for the construction of the proposed vessel according to the approved plans and specifications. If the bid of the shipbuilder who is the lowest responsible bidder is determined by the Secretary of Commerce to be fair and reasonable, the Secretary of Commerce may approve such bid, and if such approved bid is accepted by the proposed ship purchaser, the Secretary of Commerce is authorized to enter into a contract with the successful bidder for the construction, outfitting, and equipment of the proposed vessel, and for the payment by the Secretary of Commerce to the shipbuilder, on terms to be agreed upon in the contract, of the contract price of the vessel, out of the construction fund hereinbefore referred to, or out of other available funds. Notwithstanding the provisions of the first sentence of section 505 of this Act with respect to competitive bidding, the Secretary of Commerce is authorized, at any time prior to June 30, 1979, to accept a price for the construction of the ship which has been negotiated between a shipyard and a proposed ship purchaser if [(i) the negotiated price will result in a construction-differential subsidy that is equal to or less than 45 per centum in fiscal 1971, 43 per centum in fiscal 1972, 41 per centum in fiscal 1973, 39 per centum in fiscal 1974, 37 per centum in fiscal 1975, and 35 per centum in fiscal 1976; (ii)] (1) the proposed ship purchaser and the shipyard submit backup cost details and evidence that the negotiated price is fair and reasonable; [(iii)] (2) the Secretary of Commerce finds that the negotiated price is fair and reasonable; and [(iv)] (3) the shipyard agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment have access to and the right to examine any pertinent books, documents, papers, and records of the shipyard or any of its subcontractors related to the negotiation or performance of any contract or subcontract negotiated under this subsection and will include in its subcontracts a provision to that effect. Concurrently with entering into such contract with the shipbuilder, the Secretary of Commerce is authorized to enter into a contract for the sale of such vessel upon its completion, to the applicant if he is the proposed ship purchaser and if not to another citizen of the United States, if the Secretary of Commerce determines that such citizen possesses the ability, experience, financial resources, and other qualifications necessary for the operation and maintenance of the vessel at a price corresponding to the estimated cost, as determined by the Secretary of Commerce pursuant to the provisions of this Act, of building such vessel in a foreign shipyard.

(b) The amount of the reduction in selling price which is herein termed “construction differential subsidy” shall equal, but not exceed, the excess of the bid of the shipbuilder constructing the proposed vessel (excluding the cost of any features incorporated in the vessel for

national defense uses, which shall be paid by the Secretary in addition to the subsidy), over the fair and reasonable estimate of cost, as determined by the Secretary, of the construction of that type vessel if it were constructed under similar plans and specifications (excluding national defense features as above provided) in a foreign shipbuilding center which is deemed by the Secretary to furnish a fair and representative example for the determination of the estimated foreign cost of construction of vessels of the type proposed to be constructed. The Secretary of Commerce shall recompute such estimated foreign cost annually unless, in the opinion of the Secretary, there has been a significant change in shipbuilding market conditions. The Secretary shall publish notice of his intention to compute or recompute such estimated foreign cost and shall give interested persons, including but not limited to shipyards and shipowners and associations thereof, an opportunity to file written statement. The Secretary's consideration shall include, but not be limited to, all relevant matter so filed, and his determination shall include or be accompanied by a concise explanation of the basis of his determination. The construction differential approved and paid by the Secretary shall not exceed [55 per centum of the construction cost of the vessel, except that in the case of reconstruction or reconditioning of a passenger vessel having the tonnage, speed, passenger accommodations and other characteristics set forth in section 503 of this Act, the construction differential approved and paid shall not exceed 60 per centum of the reconstruction or reconditioning cost (excluding the cost of national defense features as above provided): *Provided, however,* That after June 30, 1970, the construction differential approved by the Secretary shall not exceed in the case of the construction, reconstruction or reconditioning of any vessel, 50 per centum of such cost] *50 percent of the cost of constructing, reconstructing, or reconditioning the vessel (excluding the cost of national defense features).* If the Secretary finds that the construction differential [exceeds the following percentages: in fiscal year 1971, 45 per centum; in fiscal year 1972, 43 per centum; in fiscal year 1973, 41 per centum; in fiscal year 1974, 39 per centum; in fiscal year 1975, 37 per centum; in fiscal year 1976 and thereafter, 35 per centum.] *exceeds, in any case, the foregoing percentage of such cost,* the Secretary may negotiate with any bidder (whether or not such person is the lowest bidder) and may contract with such bidder (notwithstanding the first sentence of section 505) for the construction, reconstruction, or reconditioning of the vessel involved in a domestic shipyard at a cost which will reduce the construction differential to [such applicable percentage, or as close thereto as possible.] *such percentage or less.* [Commencing with the fiscal year 1972 no construction contract requiring a construction-differential in excess of the applicable percentages set forth in the preceding sentence shall be entered into unless the Secretary shall have given due consideration to the likelihood that the above percentages will not be attained and that the commitment to the ship construction program may not be continued. If the Secretary of Commerce enters into such a contract, he shall notify the Commission on American Shipbuilding of such contract and the Commission on American Shipbuilding shall, not later than six months after such notification submit its report on the American shipbuilding industry.] In the event that the Secretary has reason to believe that the bidding

in any instance is collusive, he shall report all of the evidence on which he acted (1) to the Attorney General of the United States, and (2) to the President of the Senate and to the Speaker of the House of Representatives if the Congress shall be in session or if the Congress shall not be in session, then to the Secretary of the Senate and Clerk of the House, respectively.

TEXT OF S. 3171, AS REPORTED

A BILL To amend section 502 of the Merchant Marine Act, 1936

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Negotiated Shipbuilding Contracting Act of 1976".

SEC. 2. Section 502 (a) of the Merchant Marine Act, 1936 (46 U.S.C. 1152(a)) is amended in the third sentence thereof—

(1) by striking out "June 30, 1976" and inserting in lieu thereof "June 30, 1979";

(2) by striking out "(i) the negotiated" and all that follows through "per centum in fiscal 1976;"; and

(3) by redesignating "(ii)", "(iii)", and "(iv)" as "(1)", "(2)", and "(3)".

SEC. 3. Section 502 (b) of the Merchant Marine Act, 1936 (46 U.S.C. 1152(b)) is amended by amending the fifth, sixth, seventh, and eighth sentences thereof to read as follows: "The construction differential approved and paid by the Secretary shall not exceed 50 percent of the cost of constructing, reconstructing, or reconditioning the vessel (excluding the cost of national defense features). If the Secretary finds that the construction differential exceeds, in any case, the foregoing percentage of such cost, the Secretary may negotiate with any bidder (whether or not such person is the lowest bidder) and may contract with such bidder (notwithstanding the first sentence of section 505) for the construction, reconstruction, or reconditioning of the vessel involved in a domestic shipyard at a cost which will reduce the construction differential to such percentage or less."

AGENCY COMMENTS

COMPTROLLER GENERAL OF THE UNITED STATES,
Washington, D.C., April 7, 1976.

HON. WARREN G. MAGNUSON,
*Chairman, Committee on Commerce,
U.S. Senate.*

DEAR MR. CHAIRMAN: This is in response to an informal request from a member of your staff for our views on S. 3171, which would amend section 502 (a) of the Merchant Marine Act, 1936 (46 U.S.C. 1152(a)) to extend the authority of the Secretary of Commerce to accept a negotiated contract between a shipyard and a ship purchaser. From the information we have developed to date about the construction-differential subsidy program, administered by the Maritime Commission, we have no reason to object to the extension of the negotiation authority.

Sincerely yours,

R. F. KELLER,
*Acting Comptroller General
of the United States.*

S.R. 1013

U.S. MARITIME COMMISSION,
Washington, D.C., May 17, 1976.

HON. RUSSELL B. LONG,
*Chairman, Merchant Marine Subcommittee, Committee on Commerce,
U.S. Senate, Washington, D.C.*

DEAR SENATOR LONG: This refers to your letter, dated May 10, 1976, asking for information regarding the CDS rate and related matters pertinent to the construction of two containerships for Farrell Lines, Inc. for which competitive bids were recently opened.

Relevant data is being compiled concerning the representative foreign shipbuilding center, the estimated foreign cost of construction and the resulting CDS rate, and such materials are currently under review by the Maritime Administration staff. As yet, however, the Maritime Subsidy Board has made no decision regarding these matters.

Our work to date indicates the likelihood of determining Japan as the representative foreign shipbuilding center and further that the CDS rate will be in the range of 48 to 50 percent.

I trust the foregoing will be of assistance to you.

Sincerely,

ROBERT J. BLACKWELL,
*Assistant Secretary
for Maritime Affairs.*

○

H. R. 11504



Ninety-fourth Congress of the United States of America

AT THE SECOND SESSION

*Begun and held at the City of Washington on Monday, the nineteenth day of January,
one thousand nine hundred and seventy-six*

An Act

To amend section 502 of the Merchant Marine Act, 1936.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Negotiated Shipbuilding Contracting Act of 1976".

SEC. 2. Section 502(a) of the Merchant Marine Act, 1936 (46 U.S.C. 1152(a)) is amended in the third sentence thereof—

(1) by striking out "June 30, 1976" and inserting in lieu thereof "June 30, 1979";

(2) by striking out "(i) the negotiated" and all that follows through "per centum in fiscal 1976;"; and

(3) by redesignating "(ii)", "(iii)", and "(iv)" as "(1)", "(2)", and "(3)".

SEC. 3. Section 502(b) of the Merchant Marine Act, 1936 (46 U.S.C. 1152(b)) is amended by amending the fifth, sixth, seventh, and eighth sentences thereof to read as follows: "The construction differential approved and paid by the Secretary shall not exceed 50 per centum of the cost of constructing, reconstructing, or reconditioning the vessel (excluding the cost of national defense features). If the Secretary finds that the construction differential exceeds, in any case, the foregoing percentage of such cost, the Secretary may negotiate with any bidder (whether or not such person is the lowest bidder) and may contract with such bidder (notwithstanding the first sentence of section 505) for the construction, reconstruction, or reconditioning of the vessel involved in a domestic shipyard at a cost which will reduce the construction differential to such percentage or less."

Speaker of the House of Representatives.

*Vice President of the United States and
President of the Senate.*

Ninety-fourth Congress of the United States of America

AT THE SECOND SESSION

*Begun and held at the City of Washington on Monday, the nineteenth day of January,
one thousand nine hundred and seventy-six*

Concurrent Resolution

*Resolved by the House of Representatives (the Senate concurring),
That the Clerk of the House of Representatives in the enrollment of
the bill (H.R. 11504) to amend section 502(a) of the Merchant Marine
Act, 1936, is authorized and directed to make the following correc-
tion: strike out "502(a)" in the title of the bill and insert in lieu
thereof "502".*

Attest:

Clerk of the House of Representatives.

Attest:

Secretary of the Senate.